THE HONORABLE MARC L. BARRECA
Hearing Date: June 1, 2012
Hearing Time: 9:30 a.m.
Response Date: May 25, 2012
Hearing Location: Seattle
Chapter 7

THE UNITED STATES BANKRUPTCY COURT FOR THE
WESTERN DISTRICT OF WASHINGTON AT SEATTLE

In re ADAM GROSSMAN, Debtor.	Case No. 10-19817 RESPONSE IN OBJECTION TO MOTION TO APPROVE SETTLEMENT OF ISSUES RELATING TO REAL PROPERTY LOCATED AT 868 MONTCREST DRIVE, REDDING CALIFORNIA 96003

COMES NOW the Debtor herein, Adam R. Grossman, by and through his attorney of record Jeffrey B Wells, and in response to the trustee's motion to approve settlement of issues relating to real property located at 868 Montcrest Dr., Redding, CA, 96003, states as follows.

For the reasons set forth below the court should maintain the integrity of the Bankruptcy Code and deny the trustee's motion to approve the settlement.

BACKGROUND

On the 19th day of August, 2010, Mr. Grossman filed for Chapter 11 bankruptcy through his prior attorney in the Western District of Washington in Seattle under the present cause number. On March 11, 2011 that Chapter 11 proceeding was involuntarily converted to a

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

proceeding under Chapter 7. Because Mr. Grossman had filed two prior petitions pro se which were dismissed, the automatic stay under 11 U.S.C. § 362 did not go into effect under the provisions of § 362(c)(4)(A)(I).

While the current filing was pending, a trial occurred in the dissolution action ending the marriage between Mr. Grossman and his now former spouse, Jill Borodin. A copy of the decree of dissolution, dated December 14, 2010, stemming out of that trial is attached hereto as **Exhibit A.** That decree of dissolution purports to allocate various property between the two parties. Specifically, the decree purports to allocate to Ms. Borodin, among other properties, real property located at 868 Montcrest Drive, Redding, California.

The proposed settlement for which approval is currently sought would transfer this property, with its estimated net equity of $150,000, to Ms. Borodin for a $10,000 payment.

ABSOLUTE PRIORITY RULE

The absolute priority rule, codified under 11 U.S.C. § 726A, dictates a critical difference between the treatment of creditors in bankruptcy and that of the owners of estate property, purportedly Mr. Grossman and Ms. Borodin. Under 11 U.S.C. § 726(a)(6), the owners of the property receive payment only after all other creditors are paid.

A total of eleven creditors have filed claims in this bankruptcy directly. Debtor also filed a claim on behalf of all Tanager Fund investors as a precautionary measure after reading the trustee's report of December 13, 2011, which referenced returning funds to investors. These twelve claims amount to a total $721,000. Ms. Borodin filed a claim in the amount of $52,340. This claim is not included in this figure.

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

In filing their claims, the twelve creditors rely upon the bankruptcy court to administer the assets of the estate in an orderly fashion, ensuring that they are paid in accordance with the Bankruptcy Code. The Code dictates that these claims will be paid prior to the distribution to Debtor's spouse. This is especially important because the trustee has indicated in his motion that even if the Montcrest equity of $150,000 is included, there is estimated to be a total recovery from the three remaining properties of approximately $420,000. Based upon the administrative expenses incurred to date and the normal and usual liquidation costs, less than $400,000 will be available for distribution to these claims. To allow the proposed settlement would subvert the entire purpose of bankruptcy administration for the benefit of creditors.

COMMUNITY CLAIMS

Property of the estate includes all interests of the debtor and the debtor's spouse in community property. 11 U.S.C. §541(a)(2). Section 726(c) of the Bankruptcy Code spells out how the community property of the debtor and the debtor's spouse is to be applied to community claims. Just as the proposed settlement would violate the absolute priority rule under 11 U.S.C. §726(a)(6), the proposed settlement agreement would also eviscerate the dictates of 11 U.S.C. §726(c).

BANKRUPTCY COURT HAS EXCLUSIVE JURISDICTION

28 U.S.C. § 1334(e) states, "the district court in which a case under Title 11 is commenced or is pending shall have exclusive jurisdiction (1) of all the property, wherever located, of the Debtor as of the commencement of such case, and of property of the estate . . ." Property of the estate includes "all interest of the debtor and the debtor's spouse in community

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

property as of the commencement of the case . . ." 11 U.S.C. § 541(a)(2). If the bankruptcy court has exclusive jurisdiction, then the state court has no jurisdiction over property of the estate. The Supreme Court's plain-meaning directive in Connecticut Nat'l Bank v. Germain, 503 U.S. 249, 112 S.Ct. 1146, 1149 - 117 L.Ed. 2d 391 (1992) certainly would seem to dictate this conclusion.

28 U.S.C. § 1334(e) is a jurisdiction statute, separate and distinct from the automatic stay provisions of § 362 of the Bankruptcy Code. Thus even in the present case, where the automatic stay was not triggered by the filing of the petition, § 1334 vests the district court with the exclusive jurisdiction to administer property of the bankruptcy estate.

The 9th Circuit bankruptcy appellate panel set forth a long analysis of bankruptcy court jurisdiction in In Re Birting Fisheries, Inc. 300 B.R. 489 (9th Cir. BAP, 2003). In that case, the court emphasized that exclusive jurisdiction exists over core proceedings (citing In Re Gruntz, 202 F.3d 1074 (9th Cir. 2000)). A core proceeding is one "that invokes a substantive right provided by title 11 or...a proceeding that, by its nature, could arise only in the context of a bankruptcy case." Gruntz, supra, 202 F.3d at 1081. Core proceedings include proceedings affecting the liquidation of the assets of the estate or the adjustment of the debtor/creditor or the equity security holder relationship. See 28 U.S.C. § 157(b)(2)(O). The Panel in Birting observed:

> "A congressional grant of exclusive jurisdiction to the federal courts includes the implied power to protect that grant. Gonzalez v. Parks (In Re Gonzalez), 830 F. 2d 1033, 1036 (9th Cir. 1987)...Relying on Gruntz's "broad implications," [the court in McGhan v. Rutz (In re McGhan) 288 F.3d 1172 (9th Cir. 2001)] stated that "state court intrusions on all bankruptcy court orders (or other core bankruptcy proceedings) are barred." *Id.* at 499

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

In other areas of bankruptcy practice, courts have discussed the nature and extent of exclusive jurisdiction. For example, bankruptcy courts enjoy exclusive jurisdiction over actions brought under §§ 523(a)(2), (4), and (6) of the Bankruptcy Code. *See e.g.* In re Driscoe, 275 F.3d 895 (9th Cir. 2001); Haga v. National Union Fire Insurance Co. ,131 BR 320 (W.D. Texas, 1991); Gradco Corp v. Blankenship, 408 B.R. 845 (N.D. Ala. 2009). These actions, much like the administration of assets of the estate, are at the heart of bankruptcy proceedings.

SUPREMACY CLAUSE ESTABLISHES PRIORITY OF FEDERAL BANKRUPTCY COURT

The exclusive jurisdiction of the bankruptcy court over property of the estate and its interplay with state court dissolution proceedings has been analyzed in several cases. In In re Palmer, 78 B.R. 402 (Bankr. E.D.N.Y. 1987), dissolution and bankruptcy proceedings were pending simultaneously. While the bankruptcy court recognized that domestic relations predominantly fall within the purview of state law, it emphasized that a federal question comes into existence when a bankruptcy is involved, stating: "clearly, then, while the adjudication of all rights, duties, and entitlements as between the debtor and the spouse are within the exclusive province of the state matrimonial court, it is within the exclusive province of the bankruptcy court to adjudicate the rights of creditors as against property of the debtor and property of the estate." *Id.* at 406. This case mirrors the present one in that the bankruptcy court signed an order indicating no stay was in place, but still asserted exclusive jurisdiction.

The bankruptcy court in In re Hilsen, 100 B.R. 708 (Bankr.S.D.N.Y. 1989) likewise

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

identified this relationship when it ruled that the real property at issue was part of the bankruptcy estate and only the Chapter 7 trustee could administer it, since no dissolution award was entered pre-petition. The court indicated that it found the end result of its ruling "distasteful," but that it was obligated to rule as it did given that "Congress has specifically legislated this Court's obligation to apply the supremacy of federal law respecting 'property of the estate,' as is defined by the Bankruptcy Code." *Id.* at 711.

The bankruptcy court in In re Price, 154 B.R. 344 (Bankr. N.D.Fla 1993) similarly identified the primacy of federal law on the administration and division of property of the bankruptcy estate when it ruled that the "economic" portions of a state court judgment which provided for distribution for property could only be enforced by the bankruptcy court. It found that "once the state court proceedings affect property of the estate or dischargeable obligations of the debtor, the bankruptcy court has the power to interfere with the state court proceedings, as a federal question has now arisen and the Supremacy Clause of the United States Constitution is applicable." *Id.* at 346.

In In re Secrest, 2011 Bankr. Lexis 2753 (E.D. Virginia, 2011), the automatic stay was in effect and the court pointed to § 362(b)(2)(A)(4) as evidence that the automatic stay should not otherwise be lifted on all domestic relation matters, including equitable division of property of the estate. The court, however, in its analysis did not rely solely on that provision. While a state court dissolution may otherwise divide the property of a married couple, no actual transfer of assets can be accomplished without bankruptcy court approval due to the grant of exclusive jurisdiction of the bankruptcy court over property of the estate. This concept was central to the

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

analysis of In re Robbins, 964 F.2d 342 (4th Cir. 1992) by the Secrest court, supra at page 6, when it stated that "no property of the estate was to be transferred out of the estate." *Id.* at 17. The court further stated,

> "It is true that domestic relations is an area of law in which the state courts have a special expertise and in which the bankruptcy court should not intrude. However, the issue is not which court will hear the equitable distribution case. The state court will hear it. The issue is whether the state court should be permitted to administer the bankruptcy estate piecemeal and for the benefit of a single creditor by entering an equitable distribution award that may divest the bankruptcy estate of property of the estate. The expertise of the state court is in liquidating the domestic relations claim. The expertise of the bankruptcy court is in liquidating the property of the estate and distributing it to creditors. This court has exclusive jurisdiction over property of the estate, its liquidation, and the distribution of the proceeds to the creditors." *Id.* at 17.

Speaking further with regard to administration of assets by the bankruptcy court, the court in Secrest stated, "there is no risk that the estate will be divested of property that should be distributed to creditors." *Id.*

EXCLUSIVE JURISDICTION TO ABANDON ASSETS

Presumably the basis for the settlement is the award of the Montcrest property to Jill Borodin in the decree of dissolution. Because the bankruptcy court has exclusive jurisdiction over the assets of the bankruptcy estate, the trustee's assertion that he would have only a 20 to 30 percent chance of prevailing over the claim of Debtor's spouse seems dubious.

11 U.S.C. § 554(d) states, "unless the court orders otherwise, property of the estate that is not abandoned under this section and that is not administered in the case remains property of the estate." In the present case, since the properties purportedly transferred by the state dissolution court have been neither administered nor abandoned by Adam Grossman's Chapter

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

7 trustee under § 554, they are still property of his estate and subject to the jurisdiction of the bankruptcy court. All assets of the estate will remain unless or until either a creditor exercises its state law remedies to remove it from the estate or the Chapter 7 trustee administers or abandons it. Abandonment under § 554 occurs through motion with notice and a hearing.

The trustee's attorney has in the past asserted that because there was no automatic stay, the Montcrest property was not an asset of the bankruptcy estate. Further, the Ninth Circuit Court of Appeals in Catalano v. Commissioner of Internal Revenue, 279 F.3d 682 (9th Cir., 2002) addressed this issue. The court stated, "in short, abandonment requires formal notice and a hearing." *Id.* at 686 (citing Quarre v. Saylor,108 F.3d 219, 221 (9th Cir., 1997)). In that case the taxpayer argued that the order lifting the automatic stay in bankruptcy accomplished a de facto abandonment of the property under the Bankruptcy Code, despite the fact that no formal abandonment was obtained under 11 U.S.C. § 554. The court indicated that it had rejected such assertions in another context. The court further stated, "although the property may pass from the control of the estate, that does not mean that the estate's interest in the property is extinguished." *Id.* The court further stated, "relief from the automatic stay entitles a creditor to realize its security interest… in the property, but all proceeds in excess of the creditor's interest must be returned to the trustee." *Id.* (citing Nebel v. Richardson, 175 B.R. 306, 312 (Bankr. Neb. 1994), which in turn cites Killebrew v. Brewer, 888 F.2d 1516, 1520 (5th Cir. 1989)).

As a result, the court concluded that relief from the automatic stay does not always constitute an abandonment of property under bankruptcy law. This is particularly true in the present case where the exclusive jurisdiction of the bankruptcy court over property of the estate

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

renders void the dissolution court's award of the Montcrest property.

Other cases have likewise held that relief from the automatic stay is not analogous to abandonment of the property. *See e.g.* In re Ridgemont Apartment Associates, 105 Bankr. 738 (N.D. Ga, 1989).

To the extent the state court has already awarded and transferred assets that the trustee has not yet abandoned from the estate, such orders are void. In footnote 10 in Birting Fisheries Inc., supra the court stated:

> Gruntz and McGhan reaffirm well-established law that federal-state comity does not come into play if the state court proceedings are a legal nullity and thus void *ab initio* for lack of subject matter jurisdiction. See Audre, Inc., v. Casey (In re Audre, Inc.), 216 B.R. 19, 29 (9th Cir. BAP 1997) (a "void" judgment is one "which from its inception was a complete nullity and without legal effect"); Owens-Corning Fiberglas Corp. V. Cent. Wholesale, Inc. (In re Cent. Wholesale, Inc.) 759 F.2d 1440, 1448 (9th Cir. 1985) (a judgment "is void only if the court that rendered judgment lacked jurisdiction of the subject matter, or of the parties, or if the court acted in a manner inconsistent with due process of law").

The court in Birting Fisheries Inc., supra concluded at page 499, "in the Ninth Circuit, therefore, bankruptcy courts are not bound by incorrect state court judgments in core matters that fall within a bankruptcy court's 'arising under' jurisdiction."

SUBMITTAL TO BANKRUPTCY COURT'S JURISDICTION

Ms. Borodin filed a creditor's claim in the present bankruptcy for $52,340. In H.K. & Shanghai Banking Corp. v. Simon, 153 F.3d 991 (9th Cir. 1998), the court stated "when a creditor submits to bankruptcy court jurisdiction by filing a proof of claim in order to collect all or a portion of a debt, it assumes certain risks.…The creditor loses previously-held rights to assert 'legal claims' against the debtor and his estate; bankruptcy 'converts the creditor's legal

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

claim into an equitable claim to a pro rata share of the res.'" *Id.* at 997. By submitting her claim, Debtor's spouse has submitted herself to the jurisdiction of this court and has asserted a right to receive a pro rata share of the estate res. It would be unjust and inequitable to honor such a claim and at the same time allow her to spirit away a sizable portion of the bankruptcy estate through the dissolution proceeding.

As set forth in more detail above, in a community property state such as Washington, the absolute priority rule applies, which dictates that a spouse, or "owner," receives a distribution only after all other creditors are paid in full. But even if a spouse's creditor claim were allowed, the corollary is that she can at best expect to receive a pro-rata distribution from the estate. For example, in In re Palmer, 78 B.R. 402, 406 (Bankr. E.D.N.Y. 1987), a case from a non-community property state, the bankruptcy court held that a non-debtor spouse's rights to property "are subject to the distributions and priorities mandated by the bankruptcy code. *See* 11 U.S.C. § 507. Since the code gives [the non-debtor spouse] no right to a distribution of property of the estate superior to that of any other unsecured creditor, the bankruptcy court must supervise her entitlement in order to ensure the equality of distribution mandated by law."

Debtor's spouse cannot assert a claim and simultaneously remove a large portion of the estate assets. Either she is an owner who must await distribution only after all community creditors are paid, or she obtains status as a general creditor, who at best can expect a pro-rata distribution. Removal of the Montcrest property and its substantial equity from the estate for the benefit of a spouse, with minimal payment resulting for all other creditors, does not comport with either of these designations or with the structure of the Bankruptcy Code.

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086

TIMING

The timing of the present motion to settle is both suspect and premature. As set forth in the declaration of Adam Grossman which accompanies this response, his appeal of the dissolution decree is scheduled for decision to be made around June 5, 2012. Therefore, the claim is still subject to revision. In addition, this court has not resolved the various claims filed in this matter. As set forth in the declaration of Adam Grossman, the Tanager Fund, which has filed a claim in this matter through the Debtor, has a claim of ownership in the Glennview and Montcrest properties. That claim must be resolved before there is any disposition of either properties.

CONCLUSION

The bankruptcy court's exclusive jurisdiction to administer and abandon property of the estate and its interaction with the absolute priority rule dictate that assets of the estate and any funds recovered therefrom should be applied to the unpaid creditors, and not to the debtor and his spouse. To do otherwise subverts the entire purpose of bankruptcy administration for the benefit of creditors. No property should be distributed to parties of a dissolution if there remain unpaid creditors.

Dated this 24th of May, 2012.

_*/s/ Jeffrey B. Wells, WSBA #6317*_____________
Jeffrey B. Wells, WSBA #6317
Attorney for Debtor

*/s/ Emily A. Jarvis*___________________
Emily A. Jarvis, WSBA #6317
Attorney for the Debtor

Law Offices
JEFFREY B. WELLS
502 Logan Building
500 Union Street
Seattle, WA 98101-2332
206-624-0088 Fax 206-624-0086